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# VIRGINIA LAW REGISTER

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The question of the new revenue War Tax is one of so much interest to the profession that we deem it will not be inadvisable to take up most of our editorial space for **The New Federal Income Tax Law.** this month and give the facts in regard to the present law, and also a chart, for which we are indebted to the National City Company, National City Bank Bldg., New York. This chart, which will be found at the end of the present editorial, does not include the War Excess Profits Tax, which we understand is to be in addition to the income tax shown in the next chart and may be construed to apply to salaries and other income derived from professions and occupations, as well as business and trades. It imposes a tax of eight per cent of the individual's income in excess of \$6000.00, where no capital is employed. As we construe the law the amount of this excess tax may be deducted from the individual's income for the same year, in ascertaining the net taxable income for income tax purposes. In other words, if a person pays \$80.00 as his War Excess Profits Tax he would be entitled to deduct this \$80.00 from his income.

The new Revenue Law provides for a normal tax of two per cent. upon the incomes of all unmarried individuals in excess of \$1,000.00 and upon the incomes of all married persons or heads of families in excess of \$2,000, and graduated surtaxes ranging from one per cent. upon taxable incomes in excess of \$5,000 to fifty per cent. upon such incomes in excess of \$1,000,000.

The new law also retains in effect the income taxation authorized under the law of September 8, 1916, which provides for a normal tax of two per cent. with exemptions of \$3,000 and \$4,000, respectively, for unmarried and married taxpayers, and graduated surtaxes ranging from one per cent. upon taxable incomes in excess of \$20,000 to thirteen per cent. upon incomes in excess of \$2,000,000.

It must be noted that the war income tax of October 3rd, 1917, is in addition to the tax levied under the Income Tax Act of September 8th, 1916, and that the rates of the latter act are not changed. Then there is in addition a War Excess Profits Tax as we have heretofore set out. Some definitions might not be without value.

The statute uses the word *citizen* as a person born or naturalized in the United States, whether living in this country or abroad.

A *resident alien* is a citizen of a country other than the United States whose domicile is within the United States. He has the same status as a resident citizen.

A *non-resident alien* is a citizen of a country other than the United States, whose domicile is without the United States. Aliens temporarily living in the United States, as for a season, or other similarly definite term, are within the class of non-resident aliens.

The definition of residence would be: That place where a man has his true, fixed and permanent home and principal establishment, and to which whenever he is absent, he has intention of returning; and indicates permanency of occupation as distinct from lodging or boarding, or temporary occupation.

For the purposes of the Income Tax, it is held that where for business purposes or otherwise, an alien is permanently located in the United States; has there his principal business establishment and is there permanently occupied or employed, even though his domicile may be without the United States, he will be held to be within the definition of

"Every citizen residing in the United States, though not a citizen thereof . . . . ."

The gross income means the total of gains, profits and income for the calendar or fiscal year, as the case may be; and the head of a family referred to in this statute is defined to be: "A person who actually supports one or more individuals who are closely connected with him by blood relationship, relationship by marriage or by adoption; and whose relation is based upon some moral or legal obligation."

The exemptions under the Act of September 8th, 1916, as is

pretty well understood now, are \$3,000 for single persons and \$4,000 for married persons living together, or heads of families, whether married or single; and an exemption of \$200 is allowed for each dependent child under 18 years of age, or dependents who are physically or mentally deficient.

The Act of October 3rd, 1917, exempts the same amounts as the act of September 8th, 1916, except that exemptions of \$3,000 and \$4,000 are respectively \$1,000 and \$2,000, and \$200 for each dependent, as noted above.

The basis of levy of the additional tax is the net income at graduated rates; under the first act the total net income in excess of \$20,000, under the last act the total net income in excess of \$5,000.

The period for which the tax is levied is for the calendar year and the tax must be paid not later than June 15th. A return must be made by every single person with a net income of \$1,000 and every married person with an income of \$2,000. The rate of the tax under each act is two per cent.

The manner of computing the normal tax can best be shown as follows: If a single person has a net income of \$5,000, under the old act he would be entitled to an exemption of \$3,000, which would leave \$2,000 as the amount subject to tax; two per cent on that would be \$40; if a married person, the exemption would be \$4,000, leaving the amount subject to tax \$1,000, and the tax would be \$20. Under the new act, where the net income is \$5,000 for a single person the exemption would be \$1,000, leaving the amount subject to tax \$4,000, and the tax would be \$80. If it were a married person the exemption would be \$2,000, leaving amount subject to tax \$3,000, and the tax \$60. It must be borne in mind that both taxes must be paid, so that with a \$5,000 net income a single person would have to pay \$120, and a married person \$80. Of course an income of \$5,000 is supposed to be net after taking off the deductions allowed by law.

The returns have to be filed on or before March 1st, just as formerly and must cover the entire preceding calendar year. Returns may be made by an agent when by reason of illness, absence or non-residence the person liable for such return is unable to make and render the same; the agent assuming the re-

sponsibility of making the returns and incurring the penalties provided for erroneous, false or fraudulent returns.

The law in regard to withholding at the source applies to the normal tax only. That is to say, there is no withholding under the act of October 3rd, 1917, prior to January 1st, 1918, and then the withholding occurs as follows:

(1) On and after January 1, 1918, from fixed or determinable annual or periodical gains, profits and income of citizens and resident aliens derived from interest upon bonds and mortgages or deeds of trust or other similar obligations of corporations, associations, etc. (when such bonds, mortgages or other obligations contain a contract or provision by which the obligor agrees to pay any portion of the tax imposed by the Income Tax Law upon the obligee, or to reimburse the obligee for any portion of the tax or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay on such income, or to retain therefrom under any law of the United States) whether payable annually or at shorter or longer periods. This withholding is at the rate of two per cent. The exemption granted by Section 7 of the Act of 1916, as amended, may be claimed by taxpayer at the source by filing a claim therefor in writing on or before February 1 (Section 3, Act 1917; and 9 [c], Act 1916).

(2) From income of non-resident alien corporations, associations, etc. (not engaged in business or trade within the United States and not having an office or place of business therein) derived from interest on bonds and mortgages, deeds of trust or similar obligations of domestic or other resident corporations, associations, etc. This withholding is at the rate of four per cent.

*Exemption:* Income embraced in the return is to be credited with the amount received as dividends upon the stock, or from the net earnings of any other corporation, association, etc., which is not taxable upon its net income. Section 4.

The effect of this legislation is to provide that, (subject to the credit of dividends against net income for the purpose of the normal tax on income of corporations, associations, etc., under the Act of October 3, 1917) withholding of normal tax from income of all foreign corporations, associations, etc., as above

defined, is to be made at the rate of six per cent, combining Sections 13 (e) Act of 1916, as amended, and Section 4, Act of 1917.

Gross income includes:

1. Salaries, wages, gains from Professions, Vocations, Business, Trade, Commerce.
2. Gains and profits from sales or dealings in or growing out of ownership or use of property, real and personal.
3. Compensation for personal services.
4. Income from Interest, Rent, Dividends, Securities, Transaction of any business carried on for gain or profit; Gains, profits, income derived from any source whatever.

*Dividends:* Section 31, as amended retains the definition of dividends as contained in Section 2 (a) of the Act of September 8, 1916, and adds a provision that any dividend paid in 1917, or subsequent tax years, shall be deemed to have been declared and paid from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the dividend recipient for the year in which received, and shall be taxed at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation paying the dividend, except that earnings or profits which accrued prior to March 1, 1913, shall not be subject to tax when distributed thereafter, provided all undivided profits or surplus accumulated since March 1, 1913, shall have been first distributed. This subdivision shall not apply to any distribution made prior to August 6, 1917, out of the earnings or profits accrued prior to March 1, 1913.

In reporting the gross income the following are the exclusions:

1. (a) Proceeds of life insurance policies paid upon the death of the insured. (b) Premium returned to the insured under Life, Endowment, Annuity Contracts.
2. Property acquired by Gift, Devise, Bequest, Descent. But the income from such property shall be included as income.
3. Interest upon obligations of (a) A State or any political subdivision thereof. (b) The United States—After Sept. 1, 1917, only if and to the extent provided in the Act authorizing

the issue thereof, or (c) Its possessions. (d) Federal Farm Loan Securities, issued under Act of July 17, 1916.

4. Compensation of (a) Officers and employees of a State or any political subdivision thereof, except when such compensation is paid by the United States Government. (b) Judges of the Supreme and inferior courts of the United States, in office at the time of passage of the Act. (c) The President of the United States, in office at the time of passage of the Act.

Property acquired by gift, descent, devise or bequest, if it is subsequently sold at a price greater than the appraised value at the time the property was acquired, or if acquired prior to March 1st, 1913, the fair market price or value as of that date, the gain is held to be taxable income. Easter offerings and fees received by clergymen for funerals, marriages, baptisms, masses, etc., are regarded as income, but Christmas gifts, we are pleased to see, are not. A promissory note accepted in payment of obligation is treated as cash, and where as a part of a salary, living quarters, light, heat, etc., are received as compensation this must be treated as income, as must the money equivalent of any real or personal property, such as stocks, bonds, etc., received as compensation for services. The costs of improvement made by a tenant as part of payment of rent are to be added to rent as income. Where taxes assessed on the shares of a bank are paid on behalf of the shareholders by that bank in accordance with the usual legislation for taxation of the shares of bank stock in the states, such taxes are an allowable deduction to the shareholder and not to the bank.

The following are the deductions:

Necessary expenses actually paid within the year in carrying on any business or trade, but this does not include personal living or family expenses. All interest paid within the year on personal indebtedness except indebtedness incurred for the purchase of obligations or securities, the interest upon which is exempt from taxation as income. Tax paid within the year imposed by the authority of the United States, except income and War Excess Profits Taxes, or of any territory or possessions of any foreign country, or by the authority of any State, county, school district, municipality or other taxing subdivision of any State,

not including those assessed against local benefits. Losses actually sustained during the year, incurred in business or trade or from fires, storms, shipwrecks, casualties or theft, when such losses are not compensated for by insurance or otherwise. The Treasury Department has defined losses as follows:

Loss to be deductible must be an absolute loss, not a speculative or fluctuating valuation of continuing investment, but must be an actual loss, actually sustained and ascertained during the tax year for which the deduction is sought to be made; it must be determined and ascertained upon an actual, a completed, a closed transaction. Book values which reflect a shrinkage in the value of assets are not a basis for determining taxable income. A loss is none the less actual because an individual cannot divest himself of the possession of worthless stock by sale, but that condition alone does not give the loss in question such a character as appears to the Department to have been contemplated by the income tax law.

Losses in other transactions: In transactions entered into for profits but not connected with his business or trade, the loss actually sustained therein during the year to an amount not exceeding the profits arising therefrom.

Bad debts: Debts due to the taxpayer actually ascertained to be worthless and charged off within the year.

A reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade is exempted, but no deduction is allowed for any amount paid out for new buildings, permanent improvements or betterments made to increase the value of the property or estate, and no deductions shall be made for any amount of expenses for repairing property or making good the exhaustion thereof for which the allowance is or has been made.

The Corporation Income Tax under the first act is two per cent; under the last act it is two per cent making a total tax of four per cent as the *normal* tax.

Then there is an additional tax levied under the Act of October 3, 1917. This additional tax is ten per cent upon the amount of net income of all corporations for 1917 and subsequent years, remaining undistributed six months after the end of the calendar year, except that where a corporation has fixed its own fiscal



year under the provisions of existing law and which fiscal year ends prior to December 31, 1917, the tax shall apply to that portion of the undistributed net income of such fiscal year which shall be in the proportion which that part of the fiscal year within 1917 bears to the whole of such fiscal year.

This additional tax is not to be assessed upon that portion of undistributed net income which is actually invested or employed in the business or is retained for employment under reasonable requirement of the business; provided, that if the Secretary of the Treasury shall ascertain that the amount which thus escapes this additional tax is not so employed or is not reasonably required in the business, a tax of fifteen per cent shall be levied, assessed and paid on such amount.

For the purpose of this tax, the amount of income tax paid within the year (because not deducted in return) and the amount invested in obligations of the United States issued after September 1, 1917, will be excluded in assessing the tax.

The War Excess Profits Tax heretofore alluded to is in addition to the Income and other taxes, but the amount of this tax—and note it is only the amount of *this tax*—may be deducted from the income in assessing the income tax of the same year. The tax commences with the calendar year 1917, but where the fiscal tax of a corporation or partnership differs from the calendar year only a part of the tax will be payable for that fiscal year, proportioned to the portion of the fiscal year falling in the year 1917.

The scope of this editorial will not permit a full statement of this War Excess Profits Tax, which is exceedingly technical and should be carefully studied.

THE AMOUNT AND PERCENTAGE OF INCOME TAX UNDER THE  
LAW OF SEPTEMBER 8, 1916, AND THE NEW TAX LAW AS  
AFFECTING TAXABLE INCOMES FROM \$2,000 TO \$60,000.

The following table shows the income tax upon specified and taxable incomes of individuals under the provisions of the income tax law of September 8, 1916, the new war tax law, and the total tax payable. The table is based upon an exemption allowance of \$2,000 under the new and \$4,000 under the old law.

Under Law of Sept. 8, 1916			Under War Tax Law	
Income	Amount	Per Cent	Amount	Amount
\$ 2,000	\$ 0	0	\$ 0	\$ 0
3,000	0	0	20	20
4,000	0	0	40	40
5,000	20	.40	60	80
10,000	120	1.20	235	355
15,000	220	1.47	510	730
20,000	320	1.60	860	1,180
25,000	470	1.88	1,810	1,780
30,000	620	2.07	1,760	2,380
35,000	770	2.20	2,210	2,980
40,000	920	2.30	2,660	3,580
45,000	1,120	2.49	3,260	4,380
50,000	1,320	2.64	3,860	5,180
55,000	1,520	2.76	4,460	5,980
60,000	1,720	2.87	5,060	6,780

At its September Term our Supreme Court of Appeals unanimously reversed the decision of the State Corporation Commission in the case of *Jeffries v.*

**The Voluntary Dissolution of Public Service Corporations.**

Commonwealth, 93 S. E. 701, published in full in this issue. We published the opinion of Judge Garnett in which Judge Wingfield concurred, in our August number and commented editorially upon the case in the July number. We were not furnished with Judge Rea's dissenting opinion. The law, of course, is now as the Supreme Court has decided it. Any public service corporation has the right to dissolve, no matter how the public may be injured, and industries dependent upon transportation may be destroyed and a community deprived of its communication with the world and no hand to stay this course or say to the so-called servant of the people "Nay."

For public service corporations are servants of the people—the court holds that the public has an interest in them. If this be correct and the Court so states it, then what does that interest amount to, if it can be destroyed by the action of the corporation alone?

"Charters of incorporation are contracts between the incorporators and the State. The public has an interest in public service corporations, but does not own them. Private property invested

in a railroad enterprise becomes impressed with a public service, but still remains the property of the stockholders and cannot be confiscated," says Judge Kelley, delivering the opinion of the Court.

To every one of these propositions we give ready consent. Charters have been held, ever since the Dartmouth College case to be contracts. But being contracts, can the State pass any law abrogating them? The Dartmouth College case, and innumerable cases since, have held the contrary. Might it not be contended then that when a public service corporation is chartered there is a contract between it and the State in which the people of the State are interested and that this charter ought not to be abrogated by any law of the State? The answer is, however, obvious, that one party to a contract has a right, with the consent of the other to annul the contract and that the State has done this as to all charters by allowing them to dissolve under general laws, the passage of which are authorized by the Constitution. But whilst this might apply to corporations generally, does not a public service corporation occupy a little different position? Such corporations are given the mighty power of the State to exercise the right of Eminent Domain. The narrow guage railroad, running a little over a hundred miles, which has given rise to this decision, had the power of the State. It condemned land; it took the money of the counties through which it passed, to aid in its construction. Was there not a quasi contract between itself and the citizens whose lands it took and the counties whose money it took that they would be served for all time?

If its property was "impressed with a public service" could it destroy that property or render it useless to the public at its own sweet will? If I have an interest in property, can I be deprived of it without compensation and at the will of the other party who has a larger interest in it? Can the State authorize such a thing without violating our fundamental law? And yet the decision of the Court says it can be done. Suppose the County of Powhatan had said to the railroad, "I have an interest in this road. I will take possession of it and run it to suit myself, taking all the earnings," and proceeded to do so. How long would the County's action have lasted, even if it could have been able to carry it into effect for an instant? The question answers itself. But if the

County of Powhatan could not do this, then what right had the railroad to do practically the same thing, i. e., destroy finally and forever the interest the County and its people had in the operation of this road? "It was not a *property* interest," it may be said. Then, what sort of an interest was it? If an interest of any kind there must have been a *quasi* property right. With all due deference to the learned judge delivering the opinion of the Court, we are constrained to think that it is not in any degree the case that the private corporation should be governed by the same principles by which the public service corporations are governed. Thousands of citizens it is true, in our communities are today dependent almost entirely upon the operation of a single industrial corporation. It is not infrequent that fifty or a hundred men and their families are dependent upon the operations of a huge private plantation. But every one who takes service under the private corporation or upon the plantation is well aware that nothing can prevent both closing down their operations.

But when a public service corporation using the supreme power of the Government in exercising the right of Eminent Domain seizes the land of private citizens, and holds itself out as a public servant, the public has the right to presume that it is to be as perpetual as the Government and having obtained and used great powers, is charged with the performance of great duties which it cannot evade at its own pleasure. That it should not be compelled to run at a loss would be confiscation; but power is lodged in the Corporation Commission to allow it to increase its rates until it can be run on a basis to pay. But the public, whom it professes to serve, and for whose service the State chartered it, seems to be absolutely helpless in the present condition of the law. Is not its interest confiscated? The courts we admit must construe the law and not make it, but the courts have generally found the way to prevent the confiscation of property or the violation of inherent rights. It is to be regretted that our Court saw no way to prevent what might mean the destruction of the welfare of our communities, by the legislation it has upheld, but we draw comfort from the hope given in Judge Kelley's opinion, that the revisors of our Code have recommended notice to the public and consent of the Commission before a corporation can voluntarily dissolve. This is what the law should be and we are glad to be able to hope that it may be.